

EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

MINUTES OF THE APRIL 15, 2009 PENSION BOARD MEETING

1. Call to Order

Chairman Dr. Dean Roepke called the meeting to order at 8:35 a.m. in the Green Room of the Marcus Center, 127 East State Street, Milwaukee, Wisconsin 53202.

2. Roll Call

Members Present:

Donald Cohen
Keith Garland
Mickey Maier
Jeffrey Mawicke
Dr. Sarah Peck
Dr. Dean Roepke (Chairman)
Guy Stuller

Members Excused:

Linda Bedford (Vice Chair)
Marilyn Mayr

Others Present:

David Arena, Director of Employee Benefits, Department of Administrative Services
Gerald Schroeder, ERS Manager
Gordon Mueller, Fiscal Officer
Dale Yerkes, Assistant to the Fiscal Officer
Vivian Aikin, ERS Administrative Specialist
Bess Frank, Ad Hoc Oversight Committee
Steven Huff, Reinhart Boerner Van Deuren s.c.
Leigh Riley, Foley & Lardner LLP
William Tsotsos, Baring Asset Management
Brett Christenson, Marquette Associates, Inc.
Ray Caprio, Marquette Associates, Inc.
Steve Schultze, Reporter, Milwaukee Journal Sentinel

3. Chairman's Report

The Chairman stated that he received a notice from Artisan Partners regarding Artisan Partners' desire to reclassify one of its investment strategies. He noted that the Investment Committee should review this issue.

The Chairman stated that the Pension Board has traditionally not held an August meeting, but has met in August in recent years due to the press of business. He pointed out that whether to hold the August meeting will be a topic on the May Pension Board meeting agenda. He invited opinions from the Pension Board members at the May meeting.

4. Minutes of the March 18, 2009 Pension Board Meeting

The Pension Board reviewed the minutes of the March 18, 2009 Pension Board meeting.

The Pension Board unanimously approved the minutes of the March 18, 2009 Pension Board meeting. Motion by Mr. Maier, seconded by Mr. Cohen.

5. Reports of Employee Benefits Director, ERS Manager and Fiscal Officer

(a) Retirements Granted

Mr. Schroeder presented the Retirements Granted Report for March 2009. He reported that seven retirements were granted in March, noting that no retirees elected back DROPs.

(b) ERS Monthly Activities Report

Mr. Schroeder reported that there were 7,303 ERS retirees at the end of March and that ERS paid \$11,250,209 in benefit payments in March 2009. He indicated that there was a 20% drop in the number of retirements between 2007 (296 retirements) and 2008 (243 retirements). He also pointed out that there was a 50% decrease in the number of retirements between the first quarter of 2009 and first quarter of 2008. He commented that there has been a two-year downturn in the number of retirements. He stated that he hopes to prepare a report with a demographic breakout of ERS's retirement population in the next few months, which might show retirement trends.

In response to a question from the Chairman, Mr. Schroeder noted that ERS honors court orders regarding support payments.

Mr. Schroeder reported that the Retirement Office recently hired two college graduates for clerical specialist positions. He indicated that the County is in the process of posting the fiscal officer assistant position, which he expects will be staffed by June 1, 2009.

Mr. Schroeder provided an update on the process of the procedures writing project. He stated that the Retirement Office is preparing fiscal procedures, which will strengthen the audit trail, and V3 System procedures, which will be used to help train new employees.

Mr. Schroeder discussed the process of converting ERS's paper files into electronic files. He reported that newly hired temporary staff are scanning and imaging documents to DVD and destroying documents as permitted under documents retention law. He commented that this is a tedious process and will probably last for another year. He stated that the Retirement Office is working on

copying to DVD all ERS annual audit reports, actuarial reports and financial statements dating back to 1937. He noted that this will maintain the integrity of ERS's historical documents which need to be preserved.

Mr. Schroeder indicated that Virchow Krause performed ERS's annual financial statement audit from April 6 through April 13. He noted that Virchow Krause will provide the Retirement Office with its findings in the following week. He stated that Virchow Krause will meet with the Audit Committee in July and the Pension Board in August to discuss its findings. He reported that Virchow Krause audited approximately 150 files. Of the files audited, one file had missing information and another file contained a retroactive COLA error of approximately \$60.

(c) Cash Flow Report

Mr. Mueller explained the new format of the expanded cash flow report. He commented that the report was modified to make it easier for the reader to understand, by including larger print and definitions of certain terms. Mr. Yerkes discussed each of the line items on the cash flow report.

Mr. Yerkes stated that ERS will not need to withdraw invested funds to satisfy cash flow needs for benefit payments until the pension obligation bond funds are fully invested. He reported that the cash overlay account was funded in April. He noted that \$4.7 million was moved from a general cash account to fund the cash overlay margin account. He indicated that ERS likes to maintain at least a two-month cash reserve, which will be taken from the cash overlay account going forward. He commented that ERS wants a surplus of at least \$4 million for cash flow needs.

In response to a question from Mr. Garland, Mr. Yerkes stated that his office can provide detail for all expenditures on the cash flow report. Mr. Mueller stated that ERS will obtain the \$5 million to fund the projected April cash shortfall from the cash overlay STIF so that ERS will not need to sell off securities as it has in the past. In response to a question from the Chairman, Mr. Mueller stated that he has worked out the logistics with Marquette to have funds transferred to ERS from the cash overlay account instead of liquidating investments in the bond funds.

(d) Pension Obligation Bond Proceeds Status

Mr. Mueller reported that the County received \$397,797,000 from the issuance of the pension obligation bonds, which was transferred to the pension obligation bond STIF. He stated that a little over \$2 million in underwriting and other accounting fees were deducted from the \$400 million raised by the issuance of the pension obligation bonds. The Chairman indicated that he will send a brief report

to the County Board and County Executive to let them know that ERS received the pension obligation bond proceeds on April 2.

6. Investments

(a) Investment Manager Report – Baring Asset Management

Mr. Tsotsos distributed and presented a report on Baring Asset Management's ("Baring") management of ERS's international large cap equity strategy. He stated that the current market is a very challenging environment. He indicated that Baring is looking for growth at a reasonable price, which means that stocks purchased should be worth more than the level at which they are trading. He noted that Baring targets companies that are growing their earnings and does not specifically target any companies with specific capitalization levels. He explained that Baring tries to pick the right countries, sectors and stocks. He commented that Baring's strategy performs well in both good and bad markets. He reported that there is \$2.5 billion invested in the strategy at the present time, and the strategy will cap out and be closed to investors at between \$12-15 billion.

Mr. Tsotsos reviewed the composition of Baring's Global Equity Group. In response to a question from Dr. Peck, Mr. Tsotsos stated that Baring's Strategic Policy Group meets monthly and sets the country and sector weights that the portfolio managers should follow. He provided the example of Japan's upgrade to moderately underweight.

Mr. Tsotsos provided Baring's performance figures. He reported that Baring performed better on a relative basis in the first quarter of 2009, beating the benchmark by 5%, as Baring lost 8.8% and the benchmark lost 13.8%. He commented that gold has been a main driver of Baring's performance. Mr. Tsotsos reviewed 2008 and since inception performance figures, noting that Baring is ahead of its benchmark for both periods. He commented that the markets are extremely volatile, making implementing buys and sells challenging. In response to a question from Dr. Peck, Mr. Tsotsos stated that the investment returns are gross of fees.

Mr. Tsotsos reviewed the factors contributing to Baring's performance in the first quarter. He stated that the gold and energy sectors performed well in the first quarter. He pointed out that United Kingdom-based companies also performed well, noting that many of these companies have global operations. He discussed the top and bottom ten performing companies held by Baring in the first quarter of 2009 and for 2008. He commented that many of the companies overlap and explained the reasoning behind the companies' performance. He noted that companies with strong balance sheets perform well when external funding is limited.

In response to a question from Dr. Roepke, Mr. Tsotsos explained that Baring does buy low and may sell early, but stated that Baring sells when the stock is at or close to its peak, which may cause Baring to "leave some money on the table."

Mr. Tsotsos indicated that Baring has approximately an 80% portfolio turnover rate, and Baring holds stocks on average for approximately 18 months. He stated that Baring holds 60 companies with approximately equal weighting. He discussed the weights by sector, noting which sectors are over- or underweight. He noted that the portfolio is overweight in emerging markets, which are performing well. He commented that Baring likes insurance companies, instead of banks, especially reinsurers and property and casualty companies.

Mr. Tsotsos reviewed the companies held in the portfolio. He stated that Baring is currently looking for defensive growth and wants to avoid "value traps." In response to a question from Mr. Maier, Mr. Tsotsos explained that Baring believes that Julius Baer is the benchmark bank for big banks and is benefitting from receiving assets transferred out of UBS.

Mr. Tsotsos discussed the current themes in the markets. He noted that individual savings rates are going up, which is good for overleveraged consumers, but not for consumer companies. He commented that the effect of the additional money being printed will be inflationary, but not across the board. For example, he believes agriculture prices will be affected, but not automobile prices.

Mr. Tsotsos reviewed the Fed's balance sheet. He opined that the strength of the central banks looks weaker, which is causing Baring to look at the gold, agriculture and energy sectors. He pointed out that grain inventories are at 35-year lows. He stated that the profit growth environment will be weak. He indicated that 2009 will be a transition year, but Baring expects the market to bounce back in 2010. In response to a question from Dr. Roepke, Mr. Tsotsos stated that emerging markets currently comprise approximately 6% of the portfolio and the maximum allowable amount would be 20% of the portfolio.

(b) Marquette Associates, Inc. Report

Mr. Christenson stated that Marquette will discuss ERS's March performance and review the findings and recommendations of the ERS systems review at today's meeting. Mr. Caprio discussed the events that occurred since the last Pension Board meeting. He indicated that the pension obligation bonds were issued and ERS received the funds, which are in the process of being overlayed at a rate of 5% per week. He commented that the two other overlay programs for the uninvested cash held by ERS's domestic equity managers and for general cash are in process. He noted that two of the investments with Mellon Capital Management were transitioned from securities lending to nonsecurities lending

funds. He pointed out that the Mellon Capital Large Cap Growth Fund does not have a nonsecurities lending option available at the present time.

Mr. Caprio reported that ERS's total asset value was \$1,110,579,149 at the end of March. He stated that there has been a small rally in equities. He reviewed ERS's asset allocations against ERS's targets. He indicated that ERS gained 3.9% in March and is down 4.1% year-to-date, which is 2.5% better than its benchmark. He noted that most of ERS's investment managers met their benchmarks. He stated that Marquette has some manager alerts, which it will assess during the asset allocation study and systems review.

In response to a question from Ms. Riley, Messrs. Caprio and Christenson stated that they are comfortable with being out of compliance with the allocation ranges for international equities at the present time and noted that the allocation targets will be addressed in the asset allocation study. Dr. Peck commented that ERS is overweight in fixed income, which was good for ERS in 2008 because investment returns were relatively stronger for fixed income. Mr. Christenson agreed, but noted that being overweight in fixed income did not help ERS in March when the markets started rallying. He explained that Marquette will address the asset allocation targets during the asset allocation study after the Pension Board evaluates and indicates how it wants to allocate the portfolio.

Mr. Christenson presented Marquette's recommendations resulting from the systems review. He indicated that Marquette and the Investment Committee thoroughly discussed each of Marquette's recommendations at the last Investment Committee meeting. He stated that Marquette suggests switching Reinhart Partners' benchmark from the Russell Mid Cap Core to the Russell Mid Cap Growth benchmark. He noted that Reinhart Partners agrees with the change. He indicated that Marquette also recommends removing GMO's discretionary authority to invest among its three investment products because the Pension Board is in better position to set the target and specifically allocate its assets with respect to the entire portfolio.

Mr. Christenson stated that most of ERS's current investment managers are strong and only a few changes are needed. He explained Marquette's recommendation to terminate Capital Guardian as one of ERS's small cap international equity managers and use GMO exclusively for ERS's international small cap strategy. He reported that Capital Guardian has been among the worst performers in its asset class for each of the last three years. He acknowledged that ERS has given Capital Guardian a full market cycle, noting that Capital Guardian is in the bottom quartile of performers for the 10-year period. He point out that GMO has been in the top 9th percentile and 34th percentile over the past 5 and 10 year periods, respectively. He commented that there are few investment managers for this investment space, especially because many products are closed to new investors.

Mr. Christenson stated that this is an exciting time for institutional investors, because many opportunities will be available in such things as commercial real estate in the second half of the year. He commented that ERS is in a good position due to its strong liquidity.

The Pension Board unanimously agreed to accept Marquette's recommendations to switch Reinhart Partners' benchmark to the Russell Mid Cap Growth benchmark, to eliminate GMO's discretion to invest among its three investment products and to terminate Capital Guardian and solely use GMO as the investment manager for ERS's international small cap investment strategy. Motion by Dr. Peck, seconded by Mr. Maier.

In response to a question from Mr. Garland, Mr. Christenson explained that even though GMO is performing well, Marquette believes that the Pension Board is in the best position to determine what impact GMO should have on ERS's asset allocation and ERS's overall risk tolerance. In response to the Chairman's question, Ms. Riley stated that it would not be difficult to revise the agreements.

(c) Investment Committee Report

Dr. Peck stated that the Investment Committee discussed the systems review topics discussed by Marquette at the current Pension Board meeting at its last Investment Committee meeting. She indicated that the Investment Committee also began ERS's asset allocation study and listened to a presentation on investments in infrastructure.

7. RFP for Transition Managers

The Chairman discussed the issuance of a request for proposal to select a transition manager. He stated that based on the Milwaukee County General Ordinances, a request for proposal must be issued. He indicated that Marquette is structuring the request for proposal and the Investment Committee will review the proposal prior to sending it to the candidates. In response to a question from Mr. Stuller, Mr. Huff stated that ERS is seeking three transition managers so Marquette can choose the transition manager with the best fit when the need arises. Dr. Peck commented that not many firms provide transition management services and that by selecting three managers ERS will have contracts in place to conduct each transition more efficiently and effectively.

In response to a question from Mr. Stuller, Dr. Peck stated that the request for proposal will be written to indicate that, if chosen, the transition manager would be one of three managers selected. Mr. Mawicke explained that the main reason for selecting three candidates is to maintain flexibility by having a bench of candidates for Marquette to choose from when needed. In response to a question from Mr. Stuller, Dr. Roepke stated

that there is no firm timeline, but ERS would like to finalize the contracts before the completion of the asset allocation study.

8. Audit Committee Report

The Chairman stated that Messrs. Garland and Stuller have agreed to join the Audit Committee. He indicated that Mr. Stuller will be the Chairman of the Audit Committee. He noted that Ms. Mayr will also join the Audit Committee when she is able. He pointed out that the Audit Committee will produce a meeting schedule, which may be to meet during the first week of each month.

9. Administrative Matters

The Chairman reported on several upcoming investment conferences. He noted that Dr. Peck, Mr. Maier and Ms. Bedford will all be attending the International Foundation of Employee Benefits' Investments Conference. Mr. Cohen indicated that he will provide Mr. Schroeder with information on two audit related conferences for Mr. Schroeder to distribute to the Pension Board.

The Chairman asked if there should be any changes to the future meeting topics list. Dr. Peck stated that a number of investment topics can be removed because the topics were discussed at previous Investment Committee meetings. She noted that securities lending and brokerage should remain on the topics list. Mr. Maier commented that private real estate should be added to the investment topics list.

The Chairman reviewed the audit committee topics, which include the policies and procedures manual, securities litigation, the review of Bank of New York Mellon's most favored nations clause and proxy voting. He indicated that compliance issues, beneficiary designation questions and a review of ERS's rules should be added to the Audit Committee's future topics list.

10. Pending Litigation

The Pension Board noted that trial in the case of *Milwaukee County, et al. v. Mercer Human Resource Consulting* will be held between May 4 and 20 and that ERS has 14 seats reserved in court.

11. Report on Special Investigation

The Pension Board noted that there is nothing new to report regarding the special investigation.

12. Report on Compliance Review

The Pension Board stated that there is nothing new to report regarding the compliance review.

13. Adjournment

The meeting adjourned at 10:35 a.m.

Submitted by Steven D. Huff,
Secretary of the Pension Board